SNA/M2.22/3

19th Meeting of the Advisory Expert Group on National Accounts,
20, 26 April and 10 May 2022, Remote Meeting

Agenda item: 3

WS.9 Recording of Provisions

Introduction

During the 2008 SNA update, the issue of provisions was firstly examined by the Wellbeing & Sustainability Task Team (WSTT). This was motivated by the fact that natural resource asset values may be affected by the existence of provisions in the balance sheets of mining companies. Eventually, the issue of provisions also emerged in other guidance notes, those on retained earnings, unlisted equity and valuation of loans. To provide a holistic view on the treatment of provisions in the updated SNA/BPM, this note encompasses all types of provisions and is no longer limited to environmentally related provisions. Also, the 2008 SNA research agenda (Annex 4, D.4) warrants such guidance note since provisions are a conceptual deviation of the SNA from the accounts of businesses and public entities. This guidance note reviews the issue of provisions from a 'bird eyes view'. Its purpose is to guide the national accounting community to a way forward. Possibly, technical details will require attention at a subsequent stage.

Recommendations

- Reconsider, as part of the 2008 SNA update, the proposal of recording provisions in a supplementary table/account, as proposed in Table 2. The global consultation of the guidance note on unlisted equity showed that explicating the possible effects of provisions on unlisted equity is desirable. The global consultation of the guidance note on retained earnings indicated a majority of respondents agreed to a memorandum item showing provisions for bad loans. One may conclude these findings support recommendation (a) in this guidance note.
- In the SNA, the general recording of provisions as financial asset-liability pairs should not be pursued.
- Bring in the next SNA the recording of terminal costs in line with the general recording of provisions as proposed in this guidance note.
- Collect a few additional country examples which help us to better understand the significance of provisions and terminal costs in the context of natural resource accounting. In such an exercise, valuable experience may be obtained from exploring the statistical use of existing data sources such as the entity accounting data of corporations, financial institutions and government entities.
- Provide explicit guidance on the phenomenon of stranded assets in the next SNA and the SEEA-CF.

Divergent views

None.

Questions to AEG

- Do you agree with the recommendation to add in the upcoming SNA (and BPM) update a supplementary table/account for provisions according to the proposed Table 2 in the guidance note?
- Do you agree that provisions can be recorded as a liability without a corresponding financial asset?
- Do you agree that the recording of terminal costs should be aligned with the recording of provisions as outlined in this guidance note?
- Do you agree the next SNA (and BPM) should explicitly address how the value loss of stranded assets must be recorded?
- Do you agree the 2008 SNA/SEEA-CF guidance (i.e., as a revaluation) is correctly interpreted and reflected in the guidance note?
- Do you agree that the GN has properly incorporated the discussion on provisions undertaken by FITT and DITT?
- Do you consider the proposed global consultation questionnaire (see Annex 1) appropriate for global consultation, and that the GN is ready for global consultation?

January 10, 2022
Version 3.5

Recording of provisions – a guidance note

Mark de Haan[1]

During the 2008 SNA update, the issue of provisions was firstly examined by the wellbeing & sustainability task team (WS-TT). This was motivated by the fact that natural resource asset values may be affected by the existence of provisions in the balance sheets of mining companies. Eventually, the issue of provisions also emerged in other guidance notes, those on retained earnings, unlisted equity and valuation of loans. To provide a holistic view on the treatment of provisions in the updated SNA/BPM, this note encompasses all types of provisions and is no longer limited to environmentally related provisions. Also, the 2008 SNA research agenda (Annex 4, D.4) warrants such guidance note since provisions are a conceptual deviation of the SNA from the accounts of businesses and public entities. This guidance note reviews the issue of provisions from a 'bird eyes view'. Its purpose is to guide the national accounting community to a way forward. Possibly, technical details will require attention at a subsequent stage.

Introduction

1. The research agenda of the 2008 System of National Accounts (SNA) addresses the issue of provisions (paragraphs A4.41 - A4.43) as follows:

   "In business accounting, there are three degrees of "promises": liabilities, provisions and contingent liabilities. Their definitions are the following.

   a. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

   b. A provision is a liability of uncertain timing or amount.

   c. A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

   In the SNA, liabilities and provisions relating to financial instruments are generally recognized in the main accounts only if there is a corresponding financial asset of equal value held by a counter-party. However, it is recommended that certain provisions that do not satisfy this criterion, such as those for non-performing loans, should be recorded as memorandum items. Contingent liabilities are not recognized at all in the core accounts, except in the case of standardized guarantees.

   The problem is that recognition of a reduction in the value of an asset in the SNA necessarily implies a reduction in the corresponding liability but the asset holder may not wish to reveal to the counter-

[1] I am grateful to João Carlos Fonseca, Frans van Schaik, Peter van de Ven and several IMF colleagues for their contributions to previous versions of this guidance note. Also, I would like to thank the SEEA Area Group for their thoughtful discussions. Mistakes in this version of the guidance note are entirely mine.

party the fact that they regard some of the claim as uncollectable. Not doing so however overstates the value of the assets."

2. The paragraphs A4.41 - A4.43 in the 2008 SNA discuss provisions only in the context of the financial accounts. However, in business accounting provisions are, next to a liability, simultaneously recorded as an expense in the profit and loss account. Guidance note D.16 on the treatment of retained earnings shows that, particularly for the financial sector, obtaining information on provisions is crucial when determining income (profits) and retained earnings. Contrary to business accounting, according to the 2008 SNA, net provision changes should be added to income.

3. Paragraph 11.130 of the 2008 SNA recommends identifying transactions relating to nonperforming loans as memorandum items in the financial accounts. In addition, when they are important it may be useful to group all arrears of interest and repayment under a memorandum item. Non-performing loans are in paragraph 13.66 of the 2008 SNA defined as follows:

   "A loan is non-performing when payments of interest or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons (such as a debtor filing for bankruptcy) to doubt that payments will be made in full."

4. Of course, the presence of provisions for nonperforming loans may be a clear indication. Otherwise, the existence of nonperforming loans according to the above definition does not mean provisions have been made.

5. Except for provisions for calls under standardized guarantees, the 2008 SNA does not recognize provisions. Standardized guarantees imply that under certain conditions, loans may be canceled. For example, loans granted by government to students may eventually be canceled in case later in their professional career, earnings remain under a certain threshold.

6. Paragraph 13.79 of the 2008 SNA explains the recording of provisions for calls under standardized guarantees as follows:

   "The value to be entered in the balance sheet for provisions for calls under standardized guarantees is the expected level of claims under current guarantees less any expected recoveries. Strictly speaking, these amounts will represent a degree of double counting in the assets of the units benefiting from the guarantees. For example, if financial institutions make 1 000 loans of 20 each that are covered by guarantees and 10 are expected to default, the value of the loans made is still shown as 20 000 and in addition the lenders have an asset of 200 in respect of the expected calls under the guarantee. However, the unit offering the guarantee has a liability of 200 with no matching asset so the net worth for the whole economy is not overstated."

7. Despite any concern of double counting, the example shows that in case of a standardized guarantee, the provision is simultaneously recorded as a liability in the accounts of the lender and as an asset in the accounts of the borrowers. This is a deviation from business accounting where provisions are recorded as liabilities but not necessarily as assets.

8. The primary focus of this guidance note is on the SNA. However, the above-referred to guidance notes on *retained earnings*, *unlisted equity* and *valuation of loans* show that information on provisions can equally be critical for the balance of payments, government accounts and financial accounts.

Entity accounting standards, IFRS, IAS and IPSAS

9. Both the International Financial Reporting Standards/International Accounting Standards (IFRS/IAS) and the International Public Sector Accounting Standards (IPSAS) do recognize provisions in the entities' financial statements.

10. IAS 37 Provisions, Contingent Liabilities and Contingent Assets outlines the accounting for provisions (liabilities of uncertain timing or amount), together with contingent assets (possible assets) and contingent liabilities (possible obligations and present obligations that are not probable or not reliably measurable). Provisions are measured at the best estimate (including risks and uncertainties) of the expenditure required to settle the present obligation and reflects the present value of expenditures required to settle the obligation where the time value of money is material. The Standard aims to ensure that only genuine obligations are dealt with in the financial statements – planned future expenditure, even when authorised by the board of directors or equivalent governing body, is excluded from recognition.

11. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date, that is, the amount that an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party [IAS 37.36]. This means: Provisions for one-off events (restructuring, environmental clean-up, settlement of a lawsuit) are measured at the most likely amount [IAS 37.40]. Provisions for large populations of events (warranties, customer refunds) are measured at a probability-weighted expected value [IAS 37.39]. Both measurements are at discounted present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the liability [IAS 37.45 and 37.47]. In reaching its best estimate, the entity should consider the risks and uncertainties surrounding the underlying events [IAS 37.42].

Table 1
A few circumstances for which IAS recommends, or does not recommend, the recording of a provision

Circumstance	Recognise a provision?
Restructuring by sale of an operation	Only when the entity is committed to a sale, i.e. there is a binding sale agreement [IAS 37.78]
Restructuring by closure or reorganisation	Only when a detailed form plan is in place and the entity has started to implement the plan, or announced its main features to those affected. A Board decision is insufficient [IAS 37.72, Appendix C, Examples 5A & 5B
Warranty	When an obligating event occurs (sale of product with a warranty and probable warranty claims will be made) [Appendix C, Example 1]
Land contamination	A provision is recognised as contamination occurs for any legal obligations of clean up, or for constructive obligations if the company's published policy is to clean up even if there is no legal requirement to do so (past event is the contamination and public expectation created by the company's policy) [Appendix C, Examples 2B]
Customer refunds	Recognise a provision if the entity's established policy is to give refunds (past event is the sale of the product together with the customer's expectation, at time of purchase, that a refund would be available) [Appendix C, Example 4]
Offshore oil rig must be removed and sea bed restored	Recognise a provision for removal costs arising from the construction of the the oil rig as it is constructed, and add to the cost of the asset. Obligations arising from the production of oil are recognised as the production occurs [Appendix C, Example 3]
Abandoned leasehold, four years to run, no re-letting possible	A provision is recognised for the unavoidable lease payments [Appendix C, Example 8]

CPA firm must staff training for recent changes in tax law	No provision is recognised (there is no obligation to provide the training, recognise a liability if and when the retraining occurs) [Appendix C, Example 7]
Major overhaul or repairs	No provision is recognised (no obligation) [Appendix C, Example 11]
Onerous (loss-making) contract	Recognise a provision [IAS 37.66]
Future operating losses	No provision is recognised (no liability) [IAS 37.63]

Source: https://www.iasplus.com/en/standards/ias/ias37

12. This list is indicative. A priori, there is no reason why the scope of provisions as discussed in this GN should divert from how provisions are defined in IAS and IPSAS. For example, IPSAS 19, paragraph 1, deliberately excludes certain classes of provisions such as "provisions (…) arising from social benefits within the scope of IPSAS 42" and "provisions (…) arising from employee benefits". A commitment of a particular government entity does not necessarily represent a provision.

13. When a provision (liability) is recognised, the debit entry for a provision is often an expense but not necessarily. Sometimes the provision may form part of the cost of the asset such as the cost of inventories or an obligation for environmental clean-up when a new mine is opened, or an offshore oil rig is installed [IAS 37.8].

14. The Public Sector Accounting Standards (IPSAS 19) defines provisions in a similar way.

15. While IAS 37 explains provisions in terms of a liability, there is no guidance on the acceptance of a provision as a financial asset. Under IFRS/IPSAS the criteria to recognize provisions as liabilities is different from the criteria to recognize assets. In contrast, the common practice in the SNA to simultaneously identify financial asset and liability pairs is in the case of provisions not substantiated by the entity accounting standards.

Differences between SNA and entity accounting standards

16. In contrast to the SNA, the entity accounting standards recommend the recording of provisions under a broader range of circumstances. As the guidance notes on retained earnings and unlisted shares illustrate, this difference may complicate the translation of business accounting-based data to macroeconomic statistics.[2]

17. The differences between the SNA and the entity accounting standards may manifest themselves in several ways. Due to the recording of provisions in company balance sheets, the net worth as reported by businesses or government entities may not correspond to the net worth as defined in the 2008 SNA. Similarly, the reported profits by businesses may not correspond to primary income as defined in the 2008 SNA. Even though provisions are not acknowledged as an SNA concept, for the purpose of national accounting, an obvious practical recommendation would be for compilers to keep track of provisions in the businesses' profit and loss accounts and balance sheet source data.

18. There is a strong relationship between terminal costs (SNA) and provisions (business accounting). The list of circumstances above indicates that provisions are also recorded when

[2] In addition to the impact of provisions on income in GN D.16, GN D.2 *Valuation of unlisted equity* discusses the impact various types of provisions may have on the valuation of unlisted equity when using methods that rely on company accounting records, such as Own Funds at Book Value.

mining corporations have a future obligation to remove offshore oil rigs and to restore sea beds. In the 2008 SNA, such obligations are classified as terminal costs. The 2008 SNA explains terminal costs in a similar way as asset acquisition costs. Like acquisition costs, they are the inherent costs of gross fixed capital formation and should ideally be reflected in consumption of fixed capital. The 2008 SNA explains (paragraph 10.161) that consumption of fixed capital should cover anticipated terminal costs. This SNA recording has a few disadvantages.

19. Firstly, when moving to the end of the natural resource's service life, at some point in time the value of the oil rig will become negative. One may conclude that the capital service obtained from this asset would become negative too. This is not easily explained from an economic viewpoint.

20. Secondly, terminal costs may be untied to any preceding gross fixed capital formation. Examples are cleaning up costs and restoration of sea beds. One may classify such capital expenditure under land improvement. When such obligations are known at the start of a mining operation, the corresponding land improvement asset will be negative during its entire service life and zero at the end of its service life. Again, this is not easily explained from an economic viewpoint.

21. Even though negatively priced fixed assets are a hard to grasp concept, they are meant to represent future costs. One may argue that fair accounting requires that preceding accounting periods must anticipate these future costs. When these costs are (at large) known in advance, they should be addressed when assessing the mining operation's full value. More specifically, the expected financial obligations of mining companies may have a downward effect on the value of a natural resource asset. Without the availability of an observed market transaction, the asset must be valued as the sum of current and future resource rents. These resource rents should not include anticipated terminal costs. Similarly, no one would be willing to purchase a natural resource without taking notice of future financial obligations. Therefore, in the context of natural resource accounting, information on provisions in the balance sheets of mining companies should not be ignored.

22. Finally, contrary to the 2008 SNA, the entity accounting standards do not make a distinction between terminal costs and the legal obligations of companies or governments to compensate *third parties* for damages which are the undesired side effects of their operations. From their perspective the difference between terminal costs and compensation costs is basically non-existent. Either way a provision reflects the financial consequences at present of future obligations. The 2008 SNA keeps track of terminal costs but ignores the future obligations to third parties. The two real life examples below indicate these obligations to third parties can be significant.

The Kiruna case

The Kiruna mine is one of the largest and most modern underground iron ore mines in the world. The mine, located in Kiruna in the north of Sweden, is owned by Luossavaara-Kiirunavaara AB (LKAB), a Swedish state-owned mining company. In 2004, it was decided the present centre of the city of Kiruna would need to be relocated to accommodate mining-related subsidence. The relocation would be made gradually over decades. According to the Swedish Minerals Act, LKAB has the obligation to pay for the effects and costs that arise when the company's mining activities lead to urban transformations. To date LKAB has paid out about 11,3 billion Swedish crowns for the transformations since year 2006. At the end of December 2020 LKAB reported in their balance sheet an amount of provisions of 3,2 billion crowns (≈ 340 million US dollars).

The Groningen case

Not very long ago the gas reserves in the Dutch province of Groningen were considered a blessing, even though in the sixties and seventies it became apparent that natural resource wealth does not necessarily result in economic prosperity, a phenomenon later explained by Neary & Gorden (1982) as the Dutch disease. Nowadays the Groningen situation is by some referred to as a disaster because of the social disruption caused by mining induced earthquakes. Inhabitants suffer from fear, are uncertain about damage compensations and are facing long delays in compensation payments.

Gas extraction in the province of Groningen has been taking place since the early sixties of the previous century. In the early nineties, Groningen experienced the first earthquakes. In subsequent years these earthquakes increased in frequency and magnitude, leading to cracks in walls of many dwellings and other buildings in the Groningen area. A full assessment of the (expected) damages and required compensation payments is still difficult to make. A letter from the Minister of Economic Affairs and Climate Policy to the Dutch Parliament (16 January 2018) mentions the total damage (e.g. reconstruction of dwellings and other buildings, value losses of real estate, psychological damage) could be as much as 10 billion euros. Although at first sight this seems a considerable sum of money, as a percentage of accumulated resource rents, the expected compensation costs are quite low (≈ 0.5%). The point is of course that the State and the mining corporations have, until recently, not been accumulating parts of their gas revenues for the sake of future compensation payments. If they had done so, the costs could have been covered without blinking an eye.

The Dutch State, by way of Energie Beheer Nederland (EBN, Energy Management Netherlands), and the private sector, by way of the Nederlandse Aardolie Maatschappij (NAM, Dutch Oil Company), have been partners in the operation of the Groningen gas field. Both parties have legal obligations to compensate for the incurred damages. The financial statements of both entities (EBN and NAM) show provisions for the expected compensation costs. The government arranged a special committee (https://schadedoormijnbouw.nl) for the administrative processing of damage claims. By 1 June 2021, 83.276 claims were filed, leading so far to agreed compensation payments amounting to 1 billion euros.

→ **If decided to introduce provisions more prominently in the SNA, the SNA guidance on terminal costs must be reconsidered and brought in line with the recording of provisions.**

A review of possible SNA changes

23. This section explores a few directions in which the next version of the SNA could be supplemented with statistical information on provisions. The purpose of this section is to guide the discussion on what level of prominence the next SNA should give to provisions.

(i) Adding memorandum items or supplementary accounts

24. The 2008 SNA (11.23) indicates that:

"…where contingent positions are important for policy and analysis, it is recommended that supplementary information be collected and presented as supplementary data."

25. It is not entirely clear why the 2008 SNA suggests the option of supplementary data for contingent positions and not for provisions. The 2008 SNA (11.130) also indicates it is useful to identify transactions relating to nonperforming loans. Provisions are perhaps not a transaction, but the information on nonperforming loans could in the SNA either be replaced or supplemented by information on provisions as memorandum items. This information indicates the actual expected losses from nonperforming loans which may give the national accounts users a better understanding of the creditor's income and net worth.

26. The guidance note (D.2, Issue 3) on the valuation of unlisted equity emphasizes the following:

"The relevance of loan loss provisions, which has increased in the wake of the 2008 financial crisis, and the proliferation of non-performing loans, could have a significant impact on the valuation of unlisted companies. The general treatment of loan loss provisions, as well as the two related items—asset impairment and provisions for future payments uncertain in timing or amount—is clear and consistent between the BPM6 and 2008 SNA; both indicate that these provisions as such are not recorded in statistical accounts." Understanding the impact of this treatment on the valuation (net worth) of unlisted corporations in DI requires a careful reading of BPM6. 2008 SNA states that these amounts remain in the net worth."

The guidance note (D.16) on the treatment of retained earnings raises similar concerns:

"... profits are limited by loan provisions that they have to separate by law. As a result, profits announced by the financial corporations may depart largely from the statistical recording (..) Again, this shows that information on provisions is a crucial factor when translating balance sheet data from companies to balance of payments and national accounts."

To obtain SNA based estimates for income and net worth, both guidance notes illustrate that provisions should be removed from balance sheet and profit-loss data as obtained from businesses, financial institutions and public entities.

27. Guidance note (F.9) addresses provisions in connection to the valuation of loans. As the framework coming closest to IAS and the International Financial Reporting Standards (IFRS), the Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG 2016) (IMF, 2017) recommends recording loan loss provisions as a liability in the core accounts. The MFSMCG already provides for the financial institutions a detailed recording framework for provisions. However, the measurement of loans on the asset side remains the same as in the 2008 SNA and the BPM6, regardless of provisioning (paragraph 5.126). Also, the net worth is not impacted.

28. In other words, the 2008 SNA guidance on collecting supplementary data on nonperforming loans and contingent positions could be given more prominence in the next SNA, also addressing the importance of supplementary data on provisions, again, for two reasons:

(a) providing more detailed information on the "net worth" of institutional sectors to national accounts users. Without exposing provisions, the SNA will easily overvalue financial assets such as loans.

(b) supporting compilers to overcome the measurement issues addressed in guidance notes D.2 and D.16.

29. The guidance in the 2008 SNA on supplementary tables for contingent positions can also be found in the 1993 SNA (11.26). During the previous SNA update, Lequiller (2004) advocated for similar reasons a more prominent representation of provisions in the SNA. In a footnote (11) he argues that:

"0 country, to my knowledge, publish supplementary tables on provisions and contingent liabilities in the framework of the national accounts."

30. Lequiller proposes to incorporate provisions and impaired assets in the SNA by way of creating a table on changes in provisions which would come as an additional table, just after the 'other changes in volume' account and just before the balance sheet. In addition, the balance sheet would include the traditional value of assets and liabilities under the current SNA valuation rules plus the stock of provisions. He also suggests recording impairments of assets (nonperforming loans) in these accounts.

31. Lequiller's proposal of a 'provisions account' could give more prominence to provisions in the SNA as significant statistical information that should not be ignored. His proposal did not materialize in the 2008 SNA update. Perhaps it is time to reconsider his proposal and Table 2 in this guidance note is an attempt to do so. In this table it is suggested to present financial assets related provisions, for example those on nonperforming loans, as a separate item. One main objective of the proposed table/account would be to report data series on the net worth adjusted for provisions. The recording of such data series could be recommended when provisions substantially contribute to the (changes in) net worth of institutional sectors.

32. Table 2 shows how a supplementary dataset on provisions may extend the existent 2008 SNA framework. The 2008 SNA Table 13.1 is used as a starting point. The entries in black originates from this table. The purpose of Table 13.1 is to explain the relationship between the opening and closing balance sheets and changes in assets and liabilities. In addition to these stock and flow variables, the intent of Table 2 is to add supplementary stock and flow data for provisions which are highlighted in blue. Table 2 could be understood as a supplementary table to the current 2008 SNA Table 13.1.

Table 2
A suggested presentation of supplementary data on provisions in the next version of the SNA

	Non-financial corporations	Financial corporations	General government	Households	NPISH	Total economy
Opening Balance sheet						
Net worth *non-financial assets + financial assets − financial liabilities*	-88	-30	498	4500	210	5090
Provisions	400	120	15			535
Financial assets related		120	10			130
Other	400		5			405
Net worth *non-financial assets + financial assets − financial liabilities − provisions*	-488	-150	483	4500	210	4020
Changes in Net worth *non-financial assets + financial assets − financial liabilities*	236	4	-54	305	9	500
Provisions	20	-10	1			11
Financial assets related		-10	2			-8
Other	20		-1			19
Changes in Net worth *non-financial assets + financial assets − financial liabilities − provisions*	216	14	-55	305	9	489
Closing balance sheet						
Net worth *non-financial assets + financial assets − financial liabilities*	148	-26	444	4805	219	5590
Provisions	420	110	16			546
Financial assets related		110	12			122
Other	420		4			424
Net worth *non-financial assets + financial assets − financial liabilities − provisions*	-272	-136	428	4805	219	4498

33. The opening balance sheet in Table 2 presents in addition to the non-financial assets and financial assets/liabilities the stocks on provisions. The imaginative figures on provisions suggest most provisions related to financial assets are found in the balance sheet of the financial corporations. Other types of provisions, for example those related to mining activities, are shown in the balance sheet of the non-financial corporations.

34. In Table 2 the changes in net worth also include entries for provisions (again, indicated in blue). Compared to the presented entries, additional information could be provided, if available, on:

- on newly emerging provisions,
- closing of existing provisions and,
- existing provision reappraisals.

35. The design of closing balance sheet in Table 2 copies the opening balance sheet. In addition to the opening balance sheet, it includes all changes in provisions recorded in the observed accounting period.

36. In the case of provisions, it must be acknowledged that the national totals shown in Table 2 are probably less informative. At the national level, those provisions addressing a possible future claim vis-à-vis non-resident entities are of particular interest, as those are the ones potentially affecting the national net worth. In practice it may be difficult to assign provisions to resident/non-resident counterparts (see also issue ii). However, from the perspective of the balance of payments such a breakdown would probably be desirable. This point may require further investigation.

→ **As part of the upcoming SNA update, the proposal of a supplementary table/account for provisions should be reconsidered following the proposal in Table 2.**

(ii) Provision as an asset-liability pair

37. Issue 9 of the research agenda on the SNA website introduces provisions as follows:[3]

> *"It seems that the main reason for which national accountants reject a systematic incorporation of provisions is the fact that provisions can appear, contrary to liabilities, in the balance sheet of one entity and not, at the same time, as a counterpart entry in the balance sheet of another entity. The quadruple entry rule is thus not verified (some say the symmetry of the tables is not ensured). This happens essentially because a provision is something that is recognised by the entity which makes the promise (for example a provision for dismantling costs) and, forcibly, not by a counterpart entity1 (which can even be not known at the time of the provision).*
>
> *However, this argument of asymmetry is very weak when set against the need of users of the SNA to show the real situation of entities regarding their balance sheet and main balancing items. For example, today, the SNA overestimates the net worth of banks (by not taking into account impaired loans), and shows a biased measure of their profits, by not taking into account the change in their stock of impaired loans. This non-recognition of the principle of provisions will be even more difficult to sustain in the future as national accounts attempt to show accurate accounts for general government, when governments are more and more likely to record provisions themselves, as recommended by the International Public Sector Accounting Standards Board (IPSASB). When a major provision will be recorded by a government, with no corresponding record in the SNA version of the accounts, the inconsistency will become obvious."*

38. In this context, the following observations are relevant. Firstly, as already mentioned the identity accounting standards preliminary recognize provisions as a liability but not as an asset. Any attempt in the SNA to do so would be a step away from IFRS and IPSAS.

39. Secondly, the list of circumstances when businesses are supposed to record a provision contains examples in which a counterpart entity cannot be readily identified. For example, in the Kiruna case, it is not obvious the citizens of Kiruna can meaningfully be identified as holders of the corresponding provision asset.

40. In case we would accept the provision as a transaction between two parties, for example in the Groningen case, the moment in time in which such a transaction is supposed to take place is not easily assessed also since a provision is defined as a liability with uncertain timing or amount. A judicial confirmation of the claim may or may not coincide with the moment of recording of a provision in the balance sheet of the mining company.

41. The 'asymmetric' recording of provisions brings us to the issue of aggregation. Without acknowledging the asset side of a provision, summing up over institutional sectors may lead to understating the net worth of a country. The advantage of Lequiller's proposal is that, once

[3] https://unstats.un.org/unsd/nationalaccount/rissue.asp?rID=9

information on provisions is systematically recorded in the institutional sector accounts, these aggregation issues can be overcome without 'throwing the baby out with the bathwater'.

42. To conclude, only under a very limited number of circumstances, it might be feasible to record provisions in terms of financial asset-liability pairs.

→ **It seems not useful, nor feasible, to recommend in the SNA the recording of provisions as financial asset-liability pairs.**

(iii) Provision as a cost of production

43. The 2008 SNA provides guidance on how to record the terminal costs of mining operations. Terminal costs result from (legal) obligations to decommission e.g. oil rigs after termination of the mining operation. Ideally, terminal costs should be depreciated over the service life of the mining operation. Due to such a recording, the ex-ante determined consumption of fixed capital is rightly removed from the resource rent, i.e. the unit value of the natural resource prior to extraction times the physical amounts extracted. The residual estimation of resource rents, as recommended by the 2008 SNA (20.48) and the SEEA-CF (Table 5.5), explains that the gross operating surplus of a mining company minus the capital services (consumption of fixed capital plus the return to capital) of fixed assets should represent the mineral's resource rent.

44. In a next step the value of the natural resource asset is estimated by the net present value of current and future projected resource rents. Subtracting anticipated terminal costs from the resource rent implies that the value of the natural resource will be lower than without the presence of terminal costs. When obliged to clean up after closing of the mine, mining companies are not willing to pay as much for a mining concession as without such obligations.

45. A similar situation exists in the context of obligations to compensate third parties for the negative side effects of mining. In the case of Groningen, extracting natural gas could only take place at the expense of declining values of neighbouring buildings and dwellings. As soon as related damage claims start to emerge, one may expect the market value of the natural resource to drop, of course in case a market value would reveal itself, as natural resources are not transacted frequently.

46. This logic assumes the mining company is a price taker. If not, neglecting provisions may equally lead to overstated resource rents and natural resource asset values. When the mining company would be able, after recording a provision, to increase the price of its mined minerals, the resulting increase in turnover should probably not materialize in higher resource rents but in higher production costs, including an (implicit) provision charge.

47. Due to uncertainties about timing and amounts, the recommended recording of consumption of fixed assets anticipating future terminal costs may not be widely practiced. It would be useful to investigate the accounting practices of the national statistical offices at present. The 'opt out' is to record a consumption of fixed capital to the full amount once the terminal costs materialize. From a natural resource accounting viewpoint, this is not a helpful recording as it may contribute to overstated natural resource values in the previous accounting periods.

48. A supplementary question is how data on provisions, more broadly, could be translated to production costs. As mentioned, IAS 37 does not make the distinction between terminal costs and other types of provisions. IAS explains that, depending on the type of provision, the debit entry of a provision is an expense. Obviously, such a one-off recording is not recommendable in the current account of the SNA. Like the consumption of fixed capital linked to terminal costs,

the costs of other sorts of provisions should equally be spread over the (remaining) service life of the mining operation. Since provisions are by convention addressing uncertain future events, both in terms of amount *and* timing, spreading their costs over time will require a careful case-by-case analysis.

49. This guidance note presents evidence from Sweden and the Netherlands. For the benefit of natural resource accounting, it could be useful to broader investigate the significance of provisions, including terminal costs, particularly in the context of properly estimating the resource rents of mineral and energy resources. Anyhow, the introduction of provisions in the SNA requires a reconsideration of the currently recommended recording of terminal costs. There are two options:

- Remove those provisions addressing terminal costs from the provisions as presented in Table 2 of this guidance note.
- Bring the recording of terminal costs in line with the general recording of provisions.

50. The second option would enhance the concordance between the SNA and the entity accounting standards (IAS, IPSAS). Another advantage of classifying terminal costs as provisions is that the occurrence of unexplainable negative fixed asset values is mitigated. This leads to the following recommendation:

→ **Bring in the next SNA the recording of terminal costs in line with the general recording of provisions as proposed in this guidance note.**

51. A ‘ provision charge’ could be introduced in the next SNA and the SEEA-CF to allow for the recording of resource rents net of costs addressing future claims, either terminal costs or other claims. A provision charge could be defined as the periodic amount of money that needs to be set aside to meet future obligations, just like consumption of capital on terminal costs is operationalized in the 2008 SNA. To strengthen our view on the potential gravity of these costs, it would be useful to collect, in addition to the Kiruna and Groningen cases, a few other country examples explaining the significance of terminal costs and other types of provisions in the context of mining.

52. Mitigation objectives as laid down in the Paris agreement should in the coming years result in strong worldwide reductions in fossil fuel consumption. Particularly, a rapid phasing out of coal consumption is foreseen. These objectives are expectedly causing losses in the values of corresponding energy resources, as soon as the prices of these fossil energy carriers will start to fall. In addition, downwardly bended extraction path projections may additionally give rise to declining energy resource asset values. This phenomenon is also known as ‘stranded assets’.

53. As indicated in the list of circumstances in Table 1 above, in business accounting, future operating losses are not allowed to be recorded as provisions. Paragraph 5.192 of the CEEA-CF, explaining the revaluation entry in the monetary asset account for mineral and energy resources (Table 5.9) is equally clear in its recommendation:

> *“The additional entry in the monetary asset account relates to the recording of revaluations which occur due either to changes in resource prices over the accounting period or to changes to assumptions underlying the NPV approaches that are typically used to value mineral and energy resources.”*

54. In other words, adjusted extraction paths due to changing energy market prices must be recorded as ‘an other change in the price of the natural resource’ (a revaluation) and not as an advanced writing off (depletion) of the natural resource.

→ **Given that soon, the stranding of assets may significantly contribute to the net worth of particularly fossil energy resource dependent economies, the next SNA and the SEEA-CF should explicitly address the recommended recording convention in this regard.**

Conclusions and possible ways forward

55. The recommendations in this guidance note are the following:

a. Reconsider, as part of the 2008 SNA update, the proposal of recording provisions in a supplementary table/account, as proposed in Table 2. The global consultation of the guidance note on unlisted equity showed that explicating the possible effects of provisions on unlisted equity is desirable. The global consultation of the guidance note on retained earnings indicated a majority of respondents agreed to a memorandum item showing provisions for bad loans. One may conclude these findings support recommendation (a) in this guidance note.

b. In the SNA, the general recording of provisions as financial asset-liability pairs should not be pursued.

c. Bring in the next SNA the recording of terminal costs in line with the general recording of provisions as proposed in this guidance note.

d. Collect a few additional country examples which help us to better understand the significance of provisions and terminal costs in the context of natural resource accounting. In such an exercise, valuable experience may be obtained from exploring the statistical use of existing data sources such as the entity accounting data of corporations, financial institutions and government entities.

e. Provide explicit guidance on the phenomenon of stranded assets in the next SNA and the SEEA-CF.

56. The AEG is invited to reflect on these recommendations.

References

Corden W.M. & J.P. Neary (1982), "Booming Sector and De-Industrialisation in a Small Open Economy", The Economic Journal, 92: 825-848.

IMF (2017) Monetary and Financial Statistics Manual and Compilation Guide 2016 (https://www.imf.org/external/pubs/ft/bop/2021/pdf/37/21-05.pdf) Lequiller F. (2004) the treatment of provisions in the national accounts: elements for the review of the SNA, paper presented at the OECD National Accounts Working Party Microsoft Word - NAES 7 - Lequiller.doc (oecd.org)

System of Environmental-Economic Accounting 2012 Central Framework, https://unstats.un.org/unsd/envaccounting/seeaRev/SEEA_CF_Final_en.pdf.

System of National Accounts 1993, https://unstats.un.org/unsd/nationalaccount/docs/1993sna.pdf

System of National Accounts 2008, https://unstats.un.org/unsd/nationalaccount/docs/SNA2008.pdf

Regarding the Kiruna Mine, the following information case was consulted:

https://samhallsomvandling.lkab.com/en/urban-transformation/a-positive-force-in-the-community/lkab-pays/

https://www.mining-technology.com/features/moving-a-town-to-save-a-mine-the-story-of-kiruna/

https://www.lkab.com/en/SysSiteAssets/documents/finansiell-information/en/annual-reports/lkab_2020_annual_and_sustainability_report.pdf